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Supreme Court of The United States

OCTOBER TERM 1974

No. 73-1671

JOE L. SMALLWOOD,

Petitioner,

v.

PEARL BREWING COMPANY, SOUTHDOWN, INC., ZAPATA NORNESS, INC., ALBERT J. RANGE AND D. DOYLE MIZE,

Respondents.

BRIEF OF THE RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF JURISDICTION

The District Court's jurisdiction was invoked by Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. §§78aa) and certain claims were retained under the doctrine of pendent jurisdiction (Third Amended Original Complaint, Rec. 153).

QUESTIONS PRESENTED

1. Whether Respondents are to be denied the protection of the Seventh Amendment on factual issues found by a jury in their favor, to wit: that the Proxy Statement of Pearl Brewing Company (Pearl) did not omit to state or fail to disclose adequately all material matters required to be stated or disclosed therein?

2. Whether there exists any conflict among the decisions of the United States Circuit Courts of Appeals on the essential elements required to establish liability in private damage actions under Sections 10(b) and 14(e) of the Securities Exchange Act of 1934 ("Exchange Act") and the rules promulgated thereunder?

3. Whether the Court of Appeals for the Fifth Circuit correctly applied the liability and materiality standards of Sections 10(b) and 14(e) and the rules promulgated thereunder?

4. Whether, if this Court grants Smallwood's petition, the interests of justice will require reconsideration of certain of Respondents' arguments, either not considered by the Fifth Circuit or rejected below, to wit:

   a. The November 18, 1969 mailing to Pearl shareholders was not a "tender offer" within the meaning of Sections 14(d) and (e) of the Exchange Act;

   b. Smallwood has no derivative standing to sue in this case;

   c. The waiver power was adequately disclosed as a matter of law; and

d. Range's potential conflict of interest was adequately disclosed as a matter of law?

STATEMENT

The story begins innocuously enough in the summer of 1968 with the commencement of a search by Pearl Brewing Company for a suitable merger partner.[1] Seeking further diversification, Pearl, a Texas corporation engaged in the manufacture of beer, soft drinks, and candy, rejected feelers from other firms in the consumer foods industry. Then, in the spring of 1969, three new merger candidates appeared — Aztec Oil & Gas Company, Infotech, and Southdown, Inc. Infotech was a start-up enterprise with no business history, and its merger offer was quickly dismissed. Aztec, a natural gas producer, offered a straight stock-for-stock exchange. Southdown, a Louisiana corporation with interests in sugar production, oil and gas, and real estate, originally offered to purchase a controlling interest in Pearl stock for cash.[2] After some preliminary negotiations, Southdown altered its proposal to provide the option of a stock-for-stock exchange in a tax-free merger.[3] The Aztec and Southdown proposals were referred to Duff, Anderson & Clark, Inc., a Chicago financing and consulting firm, for study.

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[1] The underlying reasons for Pearl's search for a merger partner were (1) the increased competition national breweries exerted on regional breweries and (2) the illness of its chief executive, Otto Koehler.

[2] In August 1969 Southdown acquired Canal Assets, Inc., which was engaged in rice milling and irrigation, and owned land and mineral interests.

[3] Southdown's proposal was that "the present owners of the controlling interest in Pearl (i.e. holders of at least 45% of the outstanding Pearl stock) would enter into an agreement with [Southdown] to sell their stock for $45 per share in cash or, at their option, in exchange for Southdown's $1.80 Cumulative Convertible Preferred Stock in a tax-free merger".

On June 26, 1969, representatives of Duff, Anderson & Clark orally reported to the Pearl Board of Directors that in their opinion both proposals would benefit Pearl, but that the Aztec offer was slightly the better of the two because it had "more upside potential near term". When the Pearl Board met again on July 7, 1969, representatives of Aztec and Southdown appeared to present their proposals. After the presentations, one of Pearl's attorneys reported to the Board that El Paso Natural Gas Company, Aztec's chief customer, was under no obligation to continue purchasing gas from Aztec. The Pearl Board then informally indicated its approval of the Southdown proposal and instructed Pearl's attorneys to meet with Southdown's attorneys in an attempt to work out a merger agreement.

A merger agreement between Pearl and Southdown was approved by the Pearl Board on July 11, 1969. The agreement provided that Pearl would be merged into Southdown and that for each share of Pearl common stock owned a shareholder would receive one share of Southdown convertible preferred stock. Pearl's obligation to consummate the merger was subject to "the fulfillment (or waiver by Pearl in writing)" of certain conditions, the most important of which would permit Pearl shareholders to "sell out" at least 45 percent of their newly acquired Southdown preferred stock on consummation of the merger for $45 a share:

> "Southdown shall have procured a firm commitment from a group of underwriters (which commitment shall be satisfactory in form and substance to the Board of Directors of Pearl) by which such underwriters will agree, for a period of ten days following the Effective Date, to purchase from those stockholders who desire to sell the same, at a price of $45 net per share, up to 45 percent of the shares of Southdown Preferred Stock into which the shares of Pearl stock held by such stockholders on the

Effective Date will have been converted upon consummation of the merger."

The purpose of requiring Southdown to gain a firm underwriting commitment was to accomplish the sell-out provision of the plan without making the merger taxable to Pearl shareholders. Although Southdown was willing to buy up to 45 percent of Pearl's stock for cash, Pearl's attorneys were of the opinion that if Southdown paid cash in addition to securities the merger would lose its tax-free status under Section 354 of the Internal Revenue Code of 1954, and the exchange of shares in the merger would become a taxable event to Pearl shareholders. Jack Guenther, one of Pearl's attorneys, testified that in his negotiations with Southdown he obtained the Pearl Board's right to waive the underwriting commitment so that Southdown could not avoid the merger by failing to procure an underwriting commitment. The purpose of the waiver power was explained to the Board when the Board approved the merger agreement. There was no testimony that it was anticipated at that time that an underwriting commitment would not prove possible. To the contrary, Guenther had received confirmation from Lehman Brothers, an investment banker, that a firm commitment was feasible.

According to testimony in the record the provision that the underwriters would purchase "for a period of ten days following the Effective Date . . . from those stockholders who desire to sell" was intended to indicate when the underwriters would purchase, not when shareholders would tender their shares for sale. The testimony at trial was that permitting shareholders ten days after the merger to tender their shares for sale to underwriters would be inconsistent with underwriters' requirements that they know before purchase the number of shares they must market.

On July 17, 1969, Pearl advised its shareholders by mail of the proposed merger with Southdown. The letter indi-

cated that both the Pearl and the Southdown Boards of Directors believed the merger to be mutually beneficial and recommended shareholder approval. Enclosed with the letter was a copy of a press release describing the basic terms of the merger proposal and stating: "It is a condition to Pearl's obligation to consummate the merger that, on the effective date of the merger, Southdown shall have obtained an underwriting commitment affording the former Pearl stockholders the opportunity to sell, at $45.00 net per share, up to 45% of the Southdown preferred stock received by them in the merger." The power of the Pearl Board to waive the underwriting commitment was not mentioned.

Pearl management communicated again with the shareholders on August 12. The materials distributed that day included a cover letter, a notice of a special shareholders' meeting to be held on September 9, 1973, a proxy, and the proxy statement with appendices. The first sentence of the proxy statement referred the reader to the merger agreement between Pearl and Southdown and indicated that a copy of the agreement could be found attached as Appendix II. The agreement, of course, contained the conditions of Pearl's obligation to merge written in full, including the power of the Pearl Board to waive them.

The proxy statement revealed that Albert Range, Executive Vice President of Pearl, would be employed by Southdown under a five-year employment contract at $75,000 per annum and that Range would become a director of Southdown. Moreover, the proxy statement indicated, as a result of the merger Range's 2,620 shares of Pearl stock would be converted into an equal number of Southdown shares. Although during preliminary negotiations between Southdown and Pearl, D. Doyle Mize, the Chairman of Southdown's Board, had discussed a stock option of 25,000 shares with Range, the proxy materials did not disclose that fact.

On September 9, 1969, the shareholders voted 1,253,337 shares to 35,449 in favor of the merger. December 10, 1969, was tentatively set as the merger date.

To implement the sell-out provision of the merger agreement, Southdown mailed to the Pearl shareholders, on November 18, 1969, a cover letter, a draft of an underwriting agreement, a preliminary prospectus, and forms. The shareholders were informed that to sell their shares of Southdown preferred stock to the underwriters upon consummation of the merger they must tender their Pearl stock certificates, with the appropriate deposit forms, to be in the hands of designated exchange agents "prior to 3:30 p.m., EST, on December 2, 1969". By December 2 approximately 545,000 shares, about 58.5 percent of the outstanding Pearl stock, had been deposited.

Through the summer and into the fall of 1969 the price of Southdown common stock had run counter to a general downward trend in the securities market. Testimony indicated that Lehman Brothers had continued to believe, and communicated this belief to Pearl's attorneys and Southdown, that a syndicate of underwriters would purchase up to 45 percent of the Southdown preferred stock at $45 a share. Late in November, however, the price of Southdown common declined precipitously. Lehman Brothers communicated to Southdown that an underwriting for more than 250,000 shares would not be possible. After talking to Mize on December 3, Range wrote to 25 Pearl shareholders, each of whom owned 5,000 or more shares of Pearl stock. He requested that those addressees who had deposited more than 25 percent of their stock for sale reduce their deposit to 25 percent. In response to this request, the number of deposited shares was reduced to approximately 255,000. Negotiations continued between Southdown and Lehman Brothers, but as the price of Southdown common continued to drop, an underwriting for even 255,000 shares became increasingly doubtful. Southdown discussed with Lehman

Brothers indemnifying the underwriters for a loss of up to $1,000,000 on the resale of the Southdown preferred. Although Lehman Brothers tentatively agreed to this plan, the value of Southdown stock dropped to the point where Lehman Brothers considered that even $1,000,000 was insufficient.

While serious discussions were still continuing between Southdown and Lehman Brothers, on December 13 discussions began between Southdown and Zapata Norness, Inc., a controlling shareholder of Southdown. According to Mize's testimony, talks with Zapata were initiated on the assumption that if Southdown would pay $1,000,000 to obtain buyers for the 255,000 deposited shares, it should pay that amount to Zapata. The idea of paying Zapata $1,000,000 to purchase the shares of Southdown preferred was discarded when Southdown was advised by its attorneys that such a payment would cause the merger to be considered a taxable transaction. Nevertheless, discussions with Zapata continued, and Zapata agreed to purchase the deposited shares for $45 a share.

The merger agreement provided that it was terminable by either party unilaterally if the merger was not consummated by December 31. On December 22, 1969, the Board of Directors of Pearl met to consider the status of the merger plans. At the meeting, the Pearl Board voted to accept Zapata's offer and approved the consummation of the merger. On December 30, 1969, Southdown and Pearl merged. Zapata then purchased the deposited shares for $45 each.

At the trial below the jury found that immediately before the merger on December 30 Pearl common stock was worth $45 a share. Each share of Southdown preferred would have been worth $45 had the merger been consummated "in accordance with the terms and conditions set forth in the agreement and plan of merger". The jury found,

however, that on actual consummation of the merger each share of Southdown preferred was worth only $37.80. Still, the price of Pearl stock had risen from about $30 to over $40 during the summer and fall of 1969. Had the merger plans been abandoned, the jury found, Pearl stock would have plummeted to $21.80 per share.

SUMMARY OF REASONS FOR DENYING CERTIORARI

Petitioner asks this Court to substitute its factual review of the extensive record below for that of the jury who tried this case, the District Judge who presided over the trial of this case and three members of the Fifth Circuit Court of Appeals. The jury was not asked (on special issues) about the culpability of any one or more of the Respondents. The District Judge who presided over the trial of this case held:

> "The waiver by the Pearl Board of the condition in the merger plan to procure an underwriting commitment was not only expressly provided for but was a decision in which the Board exercised reasonable and prudent business judgment in order to facilitate the merger (App. 9)."

The Fifth Circuit opinion reasoned:

> "Far from reflecting a 'clear, persistent, and almost defiant disregard of the securities laws and the rights of Pearl's stockholders', the record in this case shows a corporation, caught in a downward-moving securities market, attempting to salvage what it could for its shareholders of a deal made in anticipation of less gloomy days (App. 70-71)."

This Court should not add a factual-review case to its docket.

Petitioner's next attack upon the judgments below is bottomed upon the legal proposition that legal liability in private damage actions under Sections 10(b) and 14(e) exists independent of culpability. Such proposition goes

counter to prevailing authority and is urged by petitioner without the support of authority.

Petitioner's last claim is that the District Court erred in its definition of *materiality* in its charge to the jury. The definition of materiality was, at a minimum, in accordance with prevailing authority and was more favorable to petitioner than the law accords in the Second Circuit.

REASONS FOR DENYING CERTIORARI

1. *The jury determined (i) that the power to waive receipt of the underwriting commitment was adequately disclosed and (ii) that the failure to disclose Range's stock option was not the omission of a material fact; and such determinations are supported by the evidence.* The issues arising under the proxy rules relate to (i) the adequacy of disclosure of the waiver, and (ii) the materiality of the omission to describe an offered stock option respecting Albert J. Range. Respondents' position is that both such issues should have been decided favorably to them as a matter of law. Nevertheless, the jury determined them favorably to Respondents. This Court should not grant ". . . certiorari to review evidence and discuss specific facts." *United States* v. *Johnston*, 268 U.S. 220, 227 (1924).

Petitioner continues to burden his printed briefs (Pet. 8, f.n. 5) with a plethora of cases which have affixed liability on defendants under different circumstances than exist in this case.[4]

The Petition also mistakes the holding of the Fifth Circuit, in refusing to override the jury finding on the waiver power (489 F.2d 579,602-3). That holding is *not*

[4] *Mills* v. *The Electric Auto-Lite Company*, 403 F.2d 429 (7th Cir. 1968), *aff'd* 396 U.S. 375 (1970), involved a failure to disclose a conflict of interest; *Swanson* v. *American Consumer Industries, Inc.*, 415 F.2d 1326 (7th Cir. 1969), involved a failure to disclose a conflict of interest; *Beatty* v. *Bright*, 318 F. Supp. 169 (S.D. Iowa 1970) involved a failure to disclose a conflict of interest;

to the effect that, as a matter of law, a discretionary waiver power need never be disclosed unless the occasion of its exercise is foreseen, or predictable. Rather, among the *reasons for refusing to overturn a jury verdict of adequate disclosures,* the Fifth Circuit cited a complete "lack of evidence that anyone should reasonably have anticipated that the waiver provision would be material to the shareholder's decision to approve or disapprove the merger" (*ibid.,* 603). There is no legal issue presented for review by the holding of the Court of Appeals. Petitioner was unable to obtain and introduce into evidence any facts from which a jury might have inferred *inadequate* disclosure. Indeed, petitioner himself testified at trial that he saw, read and understood the waiver language in the proxy material when he received it.

The "ten day" period to which petitioner adverts was a period related to the underwriting and during which the underwriters would pay for the stock they purchased. When the underwriting was waived, the "ten day" period became irrelevant. Contrary to petitioner's bold assertion, the jury *did not* find that petitioner had a ten-day period within which to tender his stock, and indeed Respondents objected to the Court's failure to submit such an issue.

2. *There exists no conflict among the Circuit Courts of Appeals on the standard of proof required to establish liability in cases under Rule 10b-5 and Section 14(e) of the Exchange Act.* The decisions of the Courts of Appeals, cited by the Petition, show no split or conflict among the Circuits on the evidentiary standards applied under Rule

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Gould v. *American Hawaiian Steamship Co.,* 331 F. Supp. 981 (D. Delaware 1971) involved a failure to disclose the different treatment accorded certain shareholders in a merger and *Kohn* v. *American Metal Climax, Inc.,* 332 F. Supp. 1331 (E.D. Pa. 1970) involved a fact finding by the Court in a non-jury case.

10b-5 and Section 14(e)[5]. Conflicts in the application of legal standards arise when cases which are otherwise indistinguishable (or closely analagous on the facts) are decided with conflicting results. The process of elaboration or development of the law of Rule 10b-5, through careful distinction between different sets of circumstances, does not contribute confusion or generate conflict in the results.

The Fifth Circuit correctly set forth the prevailing law on Rule 10b-5 and Section 14(e) liability in private damage actions:

> "Some culpability has consistently been required as an element of proof in this Circuit in cases alleging violations of Rule 10b–5. See, e. g., Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 804; Clement A. Evans & Co. v. McAlpine, 5 Cir. 1970, 434 F.2d 100, 103, cert. denied, 402 U.S. 988, 91 S.Ct. 1660, 29 L.Ed.2d 153. And we reiterate that the elements to be proved to establish a violation of Section 14(e) are identical to those under the Rule. There is no question of requiring plaintiffs to prove scienter in its strict common law sense — that the defendants made statements they either knew to be false or knew they had no basis for believing were true. See Derry v. Peel, House of Lords 1889, 14

[5] *Ellis* v. *Carter*, 291 F.2d 270 (9th Cir. 1961) contains *dicta* to the effect that *scienter* is not required in actions under Sections 11, 12(1) and 12(2) of the *Securities Act of 1933* (which is not here in issue), but as to Rule 10b-5 holds on the narrow question of the sufficiency of the pleadings to withstand summary judgment and state a claim for private recovery. *Kohler* v. *Kohler*, 319 F.2d 634 (7th Cir. 1963) held that an accountant, retained to negotiate a stock sale, did not breach a fiduciary duty in failing to volunteer certain accounting details affecting the company; and the court noted in passing that 10b-5 did not require proof of *deliberate* dishonesty (which is, similarly, not in issue here). *Myzel* v. *Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) merely affirmed the trial court's action in overruling motion for new trial and judgment n.o.v. following full trial to a jury in which the trial court's instructions required scienter. *Stevens* v. *Vowell*, 343 F.2d 374 (10th Cir. 1965), involved a challenge to subject-matter jurisdiction. The appellate court refused to override the findings of fact by the trial court. The issue of scienter or culpability beyond mere negligence was not considered.

App. Cas. 337, 374. The trend in the federal courts has been toward a more relaxed test. See, e. g., Stevens v. Vowell, 10 Cir. 1965, 343 F.2d 374, 379 (common law fraud not required); S. E. C. v. Texas Gulf Sulphur Co., 2 Cir. 1968, 401 F.2d 833, 854 (en banc), cert. denied, sub nom., Coates v. S. E. C. & S. E. C. v. Kline, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (specific intent to defraud not required); City National Bank v. Vanderboom, 8 Cir. 1970, 422 F.2d 221, 229, cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 (knowledge of impression made not required); Kohler v. Kohler Co., 7 Cir. 1963, 319 F.2d 634, 637 (knowledge of falsity and bad faith intent to mislead not required). Some Courts have gone so far as to state, or hint, that they were abandoning the fraud requirement under Rule 10b-5. Nevertheless, liability in a private action for damages has apparently never been imposed for negligent conduct under the Rule. See Bucklo, Scienter and Rule 10b-5, 67 Nw.U.L.Rev. 562. With scienter requirements in a state of flux in the Courts of Appeals, we do not view this as the proper occasion to draw the bottom line on the degree of scienter required in this Circuit. Suffice it to say that some culpability, beyond mere negligence, is required (App. 66-67)."

In *Mitchell* v. *Texas Gulf Sulphur Company*, 446 F.2d 90, 102 (10th Cir. 1971) the case was tried to the court, which found that the defendants "knew the press release statements were incorrect and misleading, and knew or should have known that the statements would be relied upon by shareholders." Quoting the Second Circuit with approval, the Tenth Circuit continued that it "seems clear" that if corporate management was diligent and disseminated information "in good faith," Rule 10b-5 would not have been violated.[6] That case, involving insider trading, is not "in conflict with" *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973), which was an action under Section 14(a) of the Exchange Act involving violations of the proxy

[6] Compare Pet., p. 12, text and fn. 10.

rules.[7] In *White* v. *Abrams*, CCH Fed. Sec. L. Rep. ¶94,457 (9th Cir., 1974) (Current Volume) the court reversed and remanded a judgment for the plaintiff, on a jury instruction that purported to impose 10b-5 liability for misstatements or omissions, even though made in good faith and in a non-negligent manner, stating:

> "The court's instruction would impose upon Abrams a duty to insure the truthfullness and reliability of the representations he has made. We reject such a broad construction since there is no indication that Congress in passing Section 10(b) of the Securities Exchange Act of 1934, or the Securities and Exchange Commission, in issuing Rule 10b-5 thereunder, intended that anyone should be an insurer against false or misleading statements made non-negligently or in good faith. *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 280. See *List* v. *Fashion Park*, 340 F.2d 457, 463 (2d Cir.), *cert. denied*, 382 U.S. 811(1965)."

The *White* v. *Abrams* court offered a tentative set of guidelines, tailored to the facts of that case, which bear no relation to the fact at issue here. That decision cannot possibly be construed as an outright rejection of the broad "culpability" standard, adverted to by the Second Circuit in *Chris-Craft Industries, Inc.* v. *Bangor Punta*, 480 F.2d 341, 363 (2d Cir. 1973), and applied by the Fifth Circuit in this case.

Far from indicating conflict and confusion among the Circuits, in the application of standards of liability under Sections 10(b) and 14(e), the cases cited show a consistent regard for the judgment of the trier of fact, and a persis-

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[7] See also in this regard, *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 288 (3d Cir. 1971) *cert. denied*, 409 U.S. 874 (1971), cited by petitioner and involving the proxy solicitation ancillary to a merger, also tried to the district court: "In view of . . . the fact that fraud or culpability appears to be the lynchpin of Section 10(b) and the regulation thereunder, it is critical that the elements of fraud *vel non* not be predicated on mere conclusory statements."

tent requirement of "something more than mere negligence."[8]

3. *The Court of Appeals for the Fifth Circuit correctly applied the liability and materiality standards of Sections 10(b) and 14(e), and of Rule 10b-5.* The petitioner failed to obtain any of the findings of fact that would establish liability under Sections 10(b) and 14(e) or Rule 10b-5. He obtained no finding that the Merger Agreement offered (or could reasonably be construed to offer) Pearl shareholders a 10-day period following the merger to "put" or tender shares of their preferred stock directly to the underwriters. He requested no issue relating to such a finding. There is undisputed evidence in the record that the Merge. Agreement did not offer a "10-day put" following the merger. The petitioner's Special Issues Nos. 1-3 (Pet. A-78, 79) assume the elimination of a "10-day put," were therefore misleading, and were predicated on mere unsubstantiated conclusions of the petitioner. Similarly, Special Issues Nos. 15-17, on which petitioner relies heavily (Pet. 5, App. 82), assume conclusions of fact or law, and do not relate back to the proxy statement and the disclosures made in the proxy solicitation of which petitioner now claims the November 18 mailing was "an integral part".

Petitioner cannot have it both ways. There is no doubt, as the District Court held, that if the November 18 mailing is regarded separately, it could not have caused any Pearl shareholder not to deposit his stock for sale. No Pearl shareholder appeared in court to testify that he was misled by the November 18 mailing and petitioner has obtained no finding of bad faith or culpability. On the other hand, if the

[8] Petitioner argues that the Fifth Circuit acknowledges that four Circuits have stated or implied that there is no scienter or culpability requirement under Rule 10b-5 (Pet. 12), but the Court's opinion goes further than petitioner suggests:

> "Nevertheless, liability in a private action for damages has apparently never been imposed for negligent conduct under the Rule (App. 67)."

November 18 mailing is regarded as "an *integral part*" of the proxy solicitation, the Court of Appeals is surely correct: petitioner has obtained no finding of "elimination of a 10-day put" upon which to predicate the findings he relies on. Those assertions do not rest on any evidence in the record.

The Appeals Court dealt with the definition of materiality and correctly concluded that petitioner obtained a more favorable definition than that to which he was entitled.

There is no authority supporting Smallwood's attack on the District Court's charge to the jury regarding materiality. In *Clement A. Evans & Co., Inc.* v. *McAlpine,* 434 F.2d 100, 103 (5th Cir. 1970), *cert. denied* 402 U.S. 988 (1971), it was held that the proper standard of materiality was as follows:

> "With regard to nondisclosures, the issue becomes whether a reasonable investor, in light of the facts existing at the time of the nondisclosure and in the exercise of due care, would have been entitled to receive full disclosure from the party charged *and would have acted differently had the alleged non-disclosure not occurred.*" (*Citing City National Bank of Fort Smith, Ark.* v. *Vanderboom,* 422 F.2d 221 (8th Cir. 1970), *cert. denied* 399 U.S. 905; *Heit* v. *Weitzen,* 402 F.2d 909 (2nd Cir. 1968), *cert. denied,* 395 U.S. 903 (1969); *S.E.C.* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833 at 863; emphasis supplied).

More recently, in *John R. Lewis Inc.* v. *Newman,* 446 F.2d 800 (5th Cir., 1971), it was again held, in the context of an action under Section 10(b) and Rule 10b-5, that the conventional test for materiality is "whether a reasonable man *would attach importance* to the fact misrepresented in determining his course of action in the transaction in question." (At 804 citing *List* v. *Fashion Park, Inc.,* 340 F.2d 457, 462 (2nd Cir. 1965), *cert. denied* 382 U.S. 811, 86 S. Ct.

23; *Gilbert* v. *Nixon*, 429 F.2d 348, 355-56 (10 Cir. 1970) and cases cited therein). *Mills* v. *Electric Auto-Lite, supra*, upon which Smallwood relies, adverted to the "would" standard of *List* v. *Fashion Park*, holding that adequate disclosure "would have warned the stockholders to give more careful scrutiny to the terms of the merger," which the disclosure of Range's salary and proposed accession to the Southdown board did here. *Mills* states that a defect in proxy solicitation, to be material must have "a significant *propensity* to affect the voting process" and that "a cause of action cannot be established by proof of a defect so trivial, so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interest protected by § 14(a)." 396 U.S. 375 at 384. It is interesting that in the *Mills* case, which was not a case involving a construction of the court's charge to the jury, the Supreme Court cited *List* and *General Time Corp.* v. *Talley Industries, Inc.*, 403 F.2d 159, 162 (2d Cir. 1968).

In *Talley*, the Second Circuit stated:

> "The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course (at page 162)."

The District Court in the instant case refused Respondents' requested instruction on materiality, which would have included the *Talley* requirement that an omission be of such significance that it would have caused the shareholder to take action different from that which he did take. The petitioner obtained a more favorable definition of materiality than that to which the law entitles him.

4. *If this Court grants Smallwood's Petition, the interests of justice will require a reconsideration of certain of Respondents' arguments not considered by the Fifth Circuit or rejected below.*

The petition assumes throughout (i) that the November 18 mailing was a "tender offer" and (ii) that Smallwood has standing to sue derivatively on behalf of Pearl. Should the Court grant the petition, the interests of substantial justice would be served only if Respondents can obtain reconsideration of such issues. *Langes* v. *Green*, 282 U.S. 531, 535-539 (1931); and see *Mills* v. *Electric Auto-Lite, supra* at 381, n.4, and comments of Stern, 87 *Harv. L.Rev.* 763, at 774 (1974).

a. *The November 18 mailing was not a "tender offer".* The merger of Pearl into Southdown would have occurred if all Pearl shareholders had elected to retain 100% of the preferred stock issued in the merger. The November 18 mailing was not a "request" or "solicitation", and does not fall into the category of "tender offer" or "invitation for tenders" which the Williams Act sought to regulate. The November 18 mailing was the mechanical means whereby Pearl shareholders would evidence their choice of the cash sale feature of the merger.[9] "Southdown clearly did not seek to acquire control of Pearl through a cash tender offer, hostile or otherwise" (Pet. A-13). A tender offer must at least have "terms" which are being "offered." The November 18 mailing merely advised Pearl shareholders of the *procedures* by which they could evidence their choice under the terms of the Merger Agreement, as previously approved by Pearl shareholders.

b. *Petitioner has no derivative standing to sue in this case.* There is no testimony in this case that any Pearl

[9] The first sentence of the Covering Letter refers the reader to the Merger Agreement pursuant to which the letter and enclosures are being sent (Ex. Vol. 109).

shareholder failed to deposit his Preferred Stock for sale to Zapata in reliance on a "10-day put." The special issues, relied on by petitioner and relating to the November 18 mailing are derivative issues. Smallwood has no standing to sue derivatively on behalf of Pearl. See *Landy* v. *Federal Deposit Insurance Corporation,* CCH Fed. Sec. L. Reg., ¶94,094 (3d Cir.) (1973 Trans. Bind.) The present case, unlike *Superintendent of Insurance* v. *Bankers Life and Casualty Co.*, 404 U.S. 6 (1971) involved no injury to Pearl.

c. *The waiver power was adequately disclosed as a matter of law.*

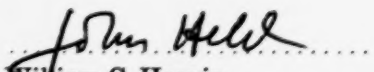
d. *Range's potential conflict of interest was adequately disclosed as a matter of law.*

The waiver power was adequately disclosed as well as was Range's potential conflict of interest. Issues inquiring about the adequate disclosure of those matters should not have been submitted to the jury, but rather should have been determined by the District Court, as a matter of law, to have been adequately disclosed. *Laurenzano* v. *Einbender,* 448 F.2d 1 (2d Cir. 1971). Furthermore, the statutes regarding disclosure in proxy materials require the absence of false and misleading statements and require affirmative disclosure of matters which, in light of matters stated, are needed to be said in order to make matters stated not misleading. Neither the statutes nor rules of the Commission require corporate reorganizations and mergers to be explained in language comprehensible to school children. *Shvetz* v. *Industrial Rayon Corp.,* 212 F. Supp. 308 (S.D.N.Y. 1960).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,



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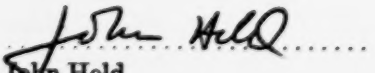
CERTIFICATE OF SERVICE

I certify that on this the 20th day of June, 1974, I mailed, certified mail, return receipt requested, two copies of Respondents' brief to Mr. John L. Hauer, Republic Bank Tower, Dallas, Texas 75201.



John Held